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No. 84-353

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN RE EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

v.

THE STATE BOARD OF EQUALIZATION,
Respondent.

On A Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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REPLY BRIEF FOR PETITIONER EDWARD W.W. HOWELL, d/b/a/ HOWELL ELECTRIC COMPANY

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In its Brief in Opposition, the California State Board of Equalization ("the Board") resorts to baseless charges in its attempt to stave off review by this Court. It complains that the legal question presented by petitioner Edward W.W. Howell, d/b/a Howell Electric Company ("Howell") "was not argued

or considered in the courts below." Br. Opp. at 3.[1] It alleges that "[t]he petition for review by this Court reflects a lack of respect for the appellate process." *Id.* It argues that Howell has "misrepresented applicable California law . . . [and] altered the record to suit his purpose." *Id.* These contentions are utterly without merit. While such rhetorical hyperbole does nothing to promote the proper resolution of this case, it is nonetheless telling that the Board virtually ignores the substance of the Ninth Circuit's opinion, and has chosen to shield the illogic of its interpretation—and application—of the California use tax behind the wholly-erroneous contention that Howell *never* raised this question below.

In light of the heat of the Brief in Opposition, it is important at the outset to understand why the Board has gone to such great lengths to avoid discussing the question presented by Howell: Whether California, by purporting to levy a use tax on Howell, is really taxing the United States. At the heart of this question is the important legal distinction between a title-based and a possessory use tax. *See, e.g.,* Howell Pet. at 5-6, 18. Since California's use tax is a title-based tax, that State can impose the tax *only* when use of personal property is incident to legal ownership of that property. *Id.* at 9-10. Accordingly, if California taxes property owned by the United States, that tax violates the Government's constitutional immunity from state taxation.

As will be demonstrated below, and despite the Board's assertions to the contrary, the record clearly indicates that the Board taxed Howell for its "use" of Government-owned property. The Board's facile attempt to downplay the importance of the legal distinction between a title-based and possessory use tax—its entire discussion of this matter is relegated to a single footnote [2]—is tacit recognition by the Board that it has no

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[1] *See also* Br. Opp. at 16 ("Howell contends that . . . the United States is the owner of the property at the time of its use and the taxing state purports to levy only a 'title-based use tax.' That question, however, is not presented in the case at hand.").

[2] *See* Br. Opp. at 22-23 n.16. In that footnote, the Board misleadingly implies that this Court, in the cases of United States v. New Mexico, 455 U.S.

(footnote continues)

authority under the California Revenue and Taxation Code to impose a use tax against Howell in this context. Under the relevant legal precedents,[3] the Board's application of the California use tax is unconstitutional since it falls squarely on the owner of the personal property at issue, the United States. It is this impermissible application, and the court of appeals' failure to take into account the precise nature of the tax being imposed, that makes this case particularly worthy of review by the Court.

1. Contrary To The Board's Allegation, The Question Presented Here Was Raised And Argued By Howell In The Court Proceedings Below.

The Board seeks to prevent this Court from reviewing the circuit court's opinion. It argues that Howell did not raise the question presented until its Petition For Rehearing by the Ninth Circuit. *See* Br. Opp. at 3-4, 14-15. This strained contention is totally inaccurate and can be quickly dismissed.

To repeat, Howell is asking this Court to review whether the Board's application of the California use tax to personal property owned by the United States is a direct tax on the Government. *See* Howell Pet. at i, 13-15. As the Board is well aware, this issue was raised by Howell at the beginning of this proceeding. Indeed, it was incorporated in paragraph 15 of the Stipulation Of Facts filed with the Bankruptcy Court, Northern District of California, on August 20, 1980.[4] We are frankly bewildered by the Board's argument in this regard since the Board itself quotes this paragraph in its Brief in Opposition. *See* Br. Opp. at 10.

(footnote continued)

720 (1982), and United States v. Boyd, 378 U.S. 39 (1964), attached no significance to the distinction between a title-based and a possessory use tax when deciding a question of federal immunity from taxation. This charactization is inaccurate. Both of these cases concerned a posessory, not a title-based use tax. *See* United States v. Boyd, 378 U.S. at 40.

[3] *See* Howell Pet. at 17-19.

[4] As the Ninth Circuit specifically noted in its opinion, the general issue of whether the Board has impermissibly levied a direct tax on the United States was also raised by Howell in its pretrial statement before the Bankruptcy Court. *See* Pet. App. A, p. 3a n.1.

Paragraph 15 of the Stipulation Of Facts provides in relevant part that:

> The parties agree that certain materials purchased by Howell and in inventory at the site of construction were not installed by Howell but passed from Howell's control to the prime contractor prior to installation pursuant to the terms of the respective prime or subcontracts. . . . Howell contends that the transfer of the inventory from Howell's control to the prime contractor was a sale for resale to the United States Government or, in the alternative, *that the Board improperly taxed the material because title thereto was transferred to the United States Government prior to any use by Howell. A copy of the typical title clause included in said prime or subcontracts is attached hereto as Exhibit C.*

Stipulation Of Facts at ¶ 15 (filed with the United States Bankruptcy Court, Northern District of California, August 20, 1980) (emphasis added).

The Board's curious assertion that the legal question presented for this Court's consideration was not argued to the Ninth Circuit is equally unavailing and patently erroneous.[5] Thus, in its reply brief to the court of appeals, Howell specifically pointed out that, under California law, there is no authority for the Board to impose a use tax on federal contractors for their use of Government-owned property. Reply Brief for Appellant at 10-11, *Howell* v. *State Board of Equalization (In re Howell)*, 731 F.2d 624 (9th Cir. 1984).

Moreover, in its papers before the Ninth Circuit—as here—Howell relied on the fundamental distinction between a title-based and a possessory use tax to demonstrate that the Board's levy of California's title-based use tax in these circumstances is unconstitutional. *Id.* The Board acknowledges only that Howell raised this question in its Petition for Rehearing before the Ninth Circuit. *See* Br. Opp. at 15.

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[5] It should be noted that the Board made virtually the same argument to the Ninth Circuit. That court properly rejected the Board's attempt to forestall Howell's right of appellate review. *See* Pet. App. A, pp. 3a-4a.

As detailed in Howell's petition, the circuit court, although confronted with the Board's impermissible application of California's use tax, completely misinterpreted the nature of the precise transaction being taxed. Howell Pet. at 13, 15. It apparently assumed that a sales tax, not a use tax, was being imposed. *Id.* In its Brief in Opposition, the Board seems to be arguing that, because the Ninth Circuit did not properly address this question, the issue is not susceptible to this Court's review. The Board, however, is confusing the issue of whether Howell raised this legal question with the entirely separate issue of whether the Ninth Circuit properly considered Howell's contention. There is not the slightest merit to this attempt to circumscribe the traditional scope of appellate review. The question presented is appropriately before this Court.

2. Pursuant To The California Revenue And Taxation Code, As Well As Under Well-Established Case Law Principles, It Is Clear That Howell Was Improperly Assessed A Use Tax On Property Owned By The United States.

In its effort to evade this Court's review, the Board also argues that Howell made taxable use of personal property *before* legal title passed to the United States. *See* Br. Opp. at 16-22. The Board—while incorrectly accusing Howell of raising a new question before this Court—contends for the first time in this proceeding that "[a] sales tax would have been applicable to that transfer [of property to Howell from its suppliers] had Howell not improperly certified to his suppliers that he was purchasing the property for resale." Br. Opp. at 14 n.11, 22. In this connection, the Board also alleges that Howell did not purchase the property for resale because it made taxable use of the property before legal title passed to the United States. The Board's novel, and inconsistent, assertions are governed by a series of unsupported and misdirected legal arguments. They are all without merit and should be rejected.

As noted directly above, the Board's contention that Howell improperly used resale certificates was never raised below. It is thus not properly before this Court. Moreover, the Board's own actions belie its belated argument. If the Board

believed that Howell did not have the authority to issue resale certificates, it should have imposed a sales tax on Howell's suppliers under section 6007.5 of the California Revenue and Taxation Code. The record of the proceedings below, as well as the Board's own admissions before this Court, indicate, however, that the Board imposed a use tax on Howell, not a sales tax on Howell's suppliers. *See* Howell Pet. at 8 & n.7. *See also* Br. Opp. at 9.

The Board's second argument, that Howell did not purchase the property for resale because it "used" that property before title passed to the Government, borders on the absurd. As detailed in its petition, Howell is an electrical contractor. It purchased electrical equipment—e.g., electrical switchgear, transformers, and generators [6]—for the sole purpose of attaching that equipment to the Government's real property. *See* Howell Pet. at 10-11.

Moreover, as to three of the contracts, Howell did not even install the electrical equipment purchased from its suppliers. It merely resold that personal property to a prime contractor. *See* Stipulation Of Facts at ¶ 15. In short, Howell had no purpose in purchasing electrical equipment from suppliers other than to resell it to the United States "in the regular course of business." CAL. REV. & TAX. CODE § 6007 (Deering 1975).

Despite this evidence, the Board argues that Howell somehow "used" the property before title passed to the United States. And it insists that such use precludes Howell from claiming either that the tax transactions are sales for resale or that they are exempt from California's use tax. There are several serious flaws in these arguments.

First, the Board totally fails to recognize that, under the current California tax scheme, a federal contractor can be exempt from both the sales and use tax if title passes to the United States before taxable use.

Second, the Board seeks to construe as "use" a federal contractor's transient possession of the property before the ultimate owner, the United States, acquires legal title. The issue in each proceeding is whether such temporary ownership is

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[6] *See* Stipulation Of Facts at ¶ 18.

taxable use. Here, it is not. This is because there must be *both* ownership and use at the same time before a use tax can be imposed in California. Here there is possession by Howell, but ownership by the United States at the time of use.

It stretches the California use tax well beyond its intended limits to argue that Howell "used" electrical equipment before attaching it to the Government's realty. As noted in Howell's petition, title passed the moment the equipment was attached to the Government's real property, or when the Government made its initial progress payment. Howell Pet. at 10, 11 & n.9, 16. Significantly, the Board in its Brief in Opposition does not, and cannot, challenge the well-settled proposition of California law that, at the precise moment personalty is affixed to realty, title passes. *Id.*

The Board's only response is to suggest that Howell is "bucking history" by challenging the Board's application of the California use tax law. It argues, in effect, that if the United States has not challenged their interpretation, it must be right. *See* Br. Opp. at 20. This is utter nonsense.

The issue of whether the Board can impose a use tax under circumstances similar to those presented here was decided in the case of *Lockheed Aircraft Corp.* v. *State Board of Equalization,* 81 Cal. App.3d 257, 146 Cal. Rptr. 283 (1978). In that action, federal-contractor taxpayers acquired or constructed special test equipment in the performance of several defense contracts. The Government contracts provided that title would pass to the Government "[w]hen any progress payment is made under" the contracts. 146 Cal. Rptr. at 286-87 n.4. The federal contractors clearly made *some* use of this equipment before progress payments were paid and title passed to the Government. The contractors actually built the special equipment that was taxed. The California court, however, rejected the Board's theory that taxable use occurred. It reasoned that use of the property "was limited to the performance of the contract." *Id.* at 287. Under these factual circumstances, the court held, the use tax could not be imposed. *Id.* at 292-93.

That reasoning applies here with even greater force. The only use Howell made of the personal property was to install or attach electrical equipment to the Government's realty. And, as pointed out above, Howell did not itself even install some of that equipment: Under three of the Government contracts, Howell merely transferred the property to another federal contractor. *See* Stipulation Of Facts at ¶ 15. The Board's claim that this constituted a taxable use of the property is inconsistent with California law and the reality of the contracts at issue. It should not be taken seriously.

3. The Board Has Failed To Explain Why The Result In This Case Should Be Different From Other Federal Decisions On The Same Issue.

The Board bobs and weaves in an effort to distinguish two federal cases that are in direct conflict with the Ninth Circuit's decision in this proceeding: *United States* v. *Nevada Tax Commission,* 291 F. Supp. 530 (D. Nev. 1968), *aff'd,* 439 F.2d 435 (9th Cir. 1971), and *Federal Reserve Bank* v. *Commissioner of Corporations and Taxation,* 520 F.2d 221 (1st Cir. 1975).

With respect to the *Nevada* case, the Board contends that the Nevada equivalent of California section 6384 was not at issue. Br. Opp. at 23. It also argues that in *Nevada,* unlike this action, the federal contractor never held title to the property in question. *Id.* at 24. These contentions are simply incorrect.

The Board's first argument is based on a patently-strained reading of the *Nevada* case. Before the circuit court, the Board claimed that the Nevada taxation scheme was different from California's. Brief for Appellee at 11-12, *Howell* v. *State Board of Equalization (In re Howell),* 731 F.2d 624 (9th Cir. 1984). Now, it admits "that the State of Nevada has a statute similar to section 6384 of the California Revenue and Taxation Code, . . ." Br. Opp. at 23. While the Nevada equivalent of section 6384 was not specifically mentioned in the *Nevada* opinion, it is obvious that this provision of the Nevada Tax Code was involved since the transaction in question concerned a sale of personal property from a supplier to a government

contractor. *Id.* Section 6384, and its Nevada counterpart, are the only statutory provisions that would cover such a tax transaction.

The Board's second argument, that this case is different because the federal contractor in *Nevada* used the property *after* title passed to the Government, is equally erroneous. As detailed above, Howell, like the federal contractor in *Nevada,* did *not* have title to the personal property being taxed. Accordingly, the legal incidence of the use tax did not fall on Howell, but directly upon the owner of the personal property at issue, the United States.

As to the *Federal Reserve Bank* case, the Board continues to ignore the simple—but determinative—fact that Massachusetts, like California, can only impose a use tax on a federal contractor when use is "incident to the ownership of that property." *See* 520 F.2d at 226. Howell, like the federal contractors in the *Federal Reserve Bank* action, had possession, but not legal title to the personal property in question. Thus, Howell cannot be taxed without running afoul of the Government's immunity from state taxation. That is what happened here.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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